

Refine Search

Search Results -

Terms	Documents
L10 and (structured near debt or structured with debt or structured adj debt or "high debt" or subordinated with debt or subordinated near debt or subordinated adj debt)	10

Database:

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 US OCR Full-Text Database
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 Derwent World Patents Index
 IBM Technical Disclosure Bulletins

Search:

L17

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Recall Text

Clear

Interrupt

Search History

DATE: Wednesday, October 17, 2007 [Purge Queries](#) [Printable Copy](#) [Create Case](#)

<u>Set</u> <u>Name</u>	<u>Query</u>	<u>Hit</u> <u>Count</u>	<u>Set</u> <u>Name</u> result set
side by side			
<i>DB=PGPB,USPT,USOC,EPAB,JPAB,DWPI,TDBD; PLUR=YES; OP=OR</i>			
<u>L17</u>	L10 and (structured near debt or structured with debt or structured adj debt or "high debt" or subordinated with debt or subordinated near debt or subordinated adj debt)	10	<u>L17</u>
<u>L16</u>	L10 and (off-balance adj sheet or "off balance sheet")	11	<u>L16</u>
<u>L15</u>	L11 and (off-balance adj sheet or "off balance sheet")	0	<u>L15</u>
<u>L14</u>	L11 and (structured near debt or structured with debt or structured adj debt or "high debt" or subordinated with debt or subordinated near debt or subordinated adj debt)	1	<u>L14</u>
<u>L13</u>	L11 and (structured near debt or structured with debt or structured adj debt or "high debt" or "subordinated debt")	1	<u>L13</u>
<u>L12</u>	L11 and (structured near debt or structured with debt or structured adj debt)	1	<u>L12</u>
<u>L11</u>	L10 and ("power plant" or "energy plant" or "electricity plant")	50	<u>L11</u>
<u>L10</u>	L9 and (financ\$ or financing)	2056	<u>L10</u>

<u>L9</u>	("project management" or project with management or project near management or project adj management)	7140	<u>L9</u>
<u>L8</u>	705.clas.	54413	<u>L8</u>
<u>L7</u>	705/1	7731	<u>L7</u>
<u>L6</u>	705/38	1323	<u>L6</u>
<u>L5</u>	705/35	3287	<u>L5</u>
<u>L4</u>	"equity valuation tool"	1	<u>L4</u>
<u>L3</u>	"project common equity"	1	<u>L3</u>
<u>L2</u>	L1 and (structured near debt or high near debt or subordinated near debt)	12	<u>L2</u>
<u>L1</u>	financing with types	430	<u>L1</u>

END OF SEARCH HISTORY

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Derivative dangers

The Quarterly Derivatives Fact Sheet from the Office of the Comptroller of the Currency (OCC) is a collection of derivative activity information from all U.S. banks. Each bank must prepare a "Condition and Income" report from which the OCC gathers its data. The most recent report available is currently the 1998 Q4 report from which the data herein was obtained.

What is a *derivative*? The OCC glossary contains the following definition: a derivative is a "...financial contract whose value is derived from the performance of assets, interest rates, currency exchange rates, or indexes. Derivative transactions include a wide assortment of financial contracts including structured debt obligations and deposits, swaps, futures, options, caps, floors, collars, forwards, and various combinations thereof...". In other words, a swap is really nothing more than a "bet" made between two parties and the result of which is a cash paid settlement from one party to the other.

Perhaps the most striking single piece of information in the report is the fact that the total amount of derivatives held by U.S. banks is \$32,999,490,000,000 -- in case you did not count the zeroes, that's **\$33 trillion!!** If you were to include the additional derivative transactions performed by the holding companies of these banks, the total would be closer to \$37 trillion. In a report from the Bank For International Settlements, global over-the-counter (OTC) derivatives total **\$70 trillion** (in U.S. Dollars), and this figure only includes OTC transactions, exchange traded transactions were not available which could present a world-wide figure closer to \$80 trillion.

This staggering sum for U.S. banks is comprised of \$10.9 trillion in futures and forwards, \$14.3 trillion in swaps, and \$7.6 trillion in options. \$24.8 trillion is concentrated in interest rates and \$7.4 trillion is in foreign exchange derivatives.

The top 7 U.S. banks hold 94% (\$30.9 trillion) of all reported derivatives. These top banks include the following (with stock symbol): Chase (CMB) includes Chemical from merger, J.P.Morgan (JPM), Citibank (CCI), NationsBank (NB), Bankers Trust (BT) in proposed merger with Deutsche Bank AG, Bank of America (BAC), and First Chicago (FCN). The top 25 U.S. banks account for 99% of all reported derivatives.

To be up-front, not all of the \$33 trillion exposure is currently at risk. Actually, when looking at only interest rate and foreign exchange derivatives, **only \$12.6 trillion** is at risk with an expiration horizon of less than one year and another \$8.1 trillion exposure for a 1-5 year expiration horizon. It should also be pointed

out that only \$122 billion in derivatives is held for less than 1 year for equities (stock market). Commodities (including gold and precious metals) are only \$70 Billion for less than one year to expiration.

The following table demonstrates the derivative positions held, by bank, for the 7 highest positions. The columns have the following meanings: **Assets** is the total assets of each bank, **Derivs** is the total derivative exposure (all expirations), **<1 Year** is the total derivative exposure that expires in less than one year, **Assets:1Yr** is the percentage of assets relative to derivatives that expire within 1 year, **Equity** is the banks exposure to the stock markets.

Bank	Assets	Derivs	<1 Year	Assets:1Yr	Equity
Chase Manhattan	297B	10,261B	4,341B	6.8%	11.3B
JPMorgan	176B	8,654B	1,948B	9.0%	53.0B
Citibank	301B	3,625B	2,067B	14.5%	15.7B
NationsBank	317B	2,701B	331B	95.8%	13.5B
Bankers Trust**	105B	2,524B	963B	10.9%	21.5B
Bank of America	257B	1,870B	781B	32.9%	0.5B
1st National Chicago	74B	1,421B	469B	15.8%	3.7B

** Deutsche Bank has proposed a takeover of Bankers Trust Corp by April 22, 1999.

Granted, not all derivative positions are at direct risk. Most positions have been countered with offsetting derivative positions with other counterparties. But, because of the extreme over-extension of their use, Chase Manhattan Bank only needs to suffer a loss of less than 7% of its 1-year derivative positions to wipe out their entire asset base. When looking at all derivative maturities, a loss of only 3% would wipe out all of Chase's assets, and only 2% is needed to wipe out the assets of JPMorgan.

The odds of a catastrophe of sufficient magnitude to wipe out more than a few percent of their derivative positions is perhaps remote. But one only has to investigate the near-collapse of the LTCM hedge fund to see how easily losses can snowball into significance.

Many of these banks participated in investing in the LTCM hedge fund, in addition to directly holding derivatives, which magnified their exposure to market fluctuations. An outright collapse of LTCM would have been a disaster for many of these banks. First, the forced liquidation of the derivatives held by LTCM would have certainly caused the markets to fall even further. Second, the leveraged exposure these banks had to the markets directly through their own derivative positions, would certainly have added to their losses. Third, with a portion of derivatives expiring on October 16, 1998, it is no wonder that the FED stepped in to assist in a multi-participation bank bailout of LTCM and announced

an *emergency* rate reduction on the day before many derivatives were set to expire.

Since most of the banks derivative positions are hedged with offsetting positions with other counterparties (called "netting"), one would be lead to assume that any real risk of loss is almost insignificant. However, there are many different kinds of exposure to derivative-loss risk, and credit and systemic risk is perhaps the most likely to occur. Systemic risk is when the failure of one party fails to meet their obligations to the other party when the derivative agreement becomes due. If LTCM had been a party for which the banks were relying on for counterparty netting, then the subsequent failure of LTCM could have caused a huge backlash and disrupted the entire global banking infrastructure.

In early 1998, LTCM had an equity to balance sheet asset ratio of 25:1. Apparently, LTCM assumed that their portfolio was quite diversified since cross-correlation between the various markets appeared to be low. However, the article ***Banks' Interactions with Highly Leveraged Institutions*** (see link below) said that following the Russian currency devaluation and announced moratorium on their debt, "... global markets simultaneously moved in the same direction, with credit spreads widening, equity markets declining and volatility increasing in various equity and interest rate markets... the confluence of these events, together with a reduction in liquidity in many markets, ultimately produced the large losses experienced by LTCM...".

The article also disclosed that of the OTC derivatives held by LTCM there were 50 counterparties involved.

LTCM was only one counterparty that was used by some of these banks. Some of the banks are counterparties with each other. There may have been other hedge funds in a similar situation as LTCM. In a world where very little information is available about the unregulated holdings of international hedge funds, one only has to wonder what would have happened if LTCM was allowed to fail. Because of a cascade of systemic risk failures, perhaps banks such as Chase or JPMorgan would have been handed their 7-9% short-term derivative losses.

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<http://www.geocities.com/WallStreet/Exchange/9807/Charts/SP500/Outlook.htm>

6 April 1999

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The **weighted average cost of capital (WACC)** is used in finance to measure a firm's cost of capital. This has been used by many firms in the past as a discount rate for financed projects, as the cost of financing (capital) is regarded by some as a logical discount rate (required rate of return) to use. Weighted Average Cost of Capital is the return a firm must earn on existing assets to keep its stock price constant and satisfy its creditors and owners.

Corporations raise money from two main sources: equity and debt. Thus the capital structure of a firm comprises three main components: preferred equity, common equity and debt (typically bonds and notes). The WACC takes into account the relative weights of each component of the capital structure and presents the expected cost of new capital for a firm.

Contents

- 1 The formula
- 2 How it works
- 3 Sources of information
- 4 Effect on valuation
- 5 References
- 6 See also
- 7 External links

The formula

The weighted average cost of capital is defined by:

$$c = \left(\frac{E}{K}\right) \cdot y + \left(\frac{D}{K}\right) \cdot b(1 - \frac{t_C}{100})$$

where

$$K = D + E$$

and the following table defines each symbol:

Symbol	Meaning	Units
<i>c</i>	<i>weighted average cost of capital</i>	%
<i>y</i>	<i>required or expected rate of return on equity, or cost of equity</i>	%
<i>b</i>	<i>required or expected rate of return on borrowings, or cost of debt</i>	%
<i>t_C</i>	<i>corporate tax rate</i>	%

<i>D</i>	<i>total debt and leases (including current portion of long-term debt and notes payable)</i>	<i>currency</i>
<i>E</i>	<i>total market value of equity and equity equivalents</i>	<i>currency</i>
<i>K</i>	<i>total capital invested in the going concern</i>	<i>currency</i>

This equation describes only the situation with homogeneous equity and debt. If part of the capital consists, for example, of preferred stock (with different cost of equity y), then the formula would include an additional term for each additional source of capital.

How it works

Since we are measuring expected cost of new capital, we should use the market values of the components, rather than their book values (which can be significantly different). In addition, other, more "exotic" sources of financing, such as convertible/callable bonds, convertible preferred stock, etc., would normally be included in the formula if they exist in any significant amounts - since the cost of those financing methods is usually different from the plain vanilla bonds and equity due to their extra features.

WACC, is a special way to measure the capital discount of the firms gaining and spending.

Sources of information

How do we find out the values of the components in the formula for WACC? First let us note that the "weight" of a source of financing is simply the market value of that piece divided by the sum of the values of all the pieces. For example, the weight of common equity in the above formula would be determined as follows:

Market value of common equity / (Market value of common equity + Market value of debt + Market value of preferred equity)

So, let us proceed in finding the market values of each source of financing (namely the debt, preferred stock, and common stock).

- The market value for equity for a publicly traded company is simply the price per share multiplied by the number of shares outstanding, and tends to be the easiest component to find.
- The market value of the debt is easily found if the company has publicly traded bonds. Frequently, companies also have a significant amount of bank loans, whose market value is not easily found. However, since the market value of debt tends to be pretty close to the book value (for companies that have not experienced significant changes in credit rating, at least), the book value of debt is usually used in the WACC formula.
- The market value of preferred stock is again usually easily found on the market, and determined by multiplying the cost per share by number of shares outstanding.

Now, let us take care of the costs.

- Preferred equity is equivalent to a perpetuity, where the holder is entitled to fixed payments forever. Thus the cost is determined by dividing the periodic payment by the price of the preferred stock, in percentage terms.
- The cost of common equity is usually determined using the capital asset pricing model.
- The cost of debt is the yield to maturity on the publicly traded bonds of the company. Failing availability of that, the rates of interest charged by the banks on recent loans to the company would also serve as a good cost of debt. Since a corporation normally can write off taxes on the interest it pays on the debt, however, the cost of debt is further reduced by the tax rate that the corporation is subject to. Thus, the cost of debt for a company becomes (YTM on bonds or interest on loans) $\times (1 - \text{tax rate})$. In fact, the tax deduction is usually kept in the formula for WACC, rather than being rolled up into cost of debt, as such:

$$\begin{aligned} \text{WACC} = & \text{weight of preferred equity} \times \text{cost of preferred equity} \\ & + \text{weight of common equity} \times \text{cost of common equity} \\ & + \text{weight of debt} \times \text{cost of debt} \times (1 - \text{tax rate}) \end{aligned}$$

And now we are ready to plug all our data into the WACC formula.

Effect on valuation

The economists Merton Miller and Franco Modigliani showed in the Modigliani-Miller theorem that in a perfect economy without taxes, a firm's cost of capital (and thus the valuation) does not depend on the debt to equity ratio. However, many governments allow a tax deduction on interest and thus in such an environment, there is a bias towards debt financing.

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- M. Miller and F. Modigliani. "Corporate income taxes and the cost of capital: a correction." *American Economic Review*, 53 (3) (1963), pp. 433-443.
- J. Miles und J. Ezzell. "The weighted average cost of capital, perfect capital markets and project life: a clarification." *Journal of Financial and Quantitative Analysis*, 15 (1980), S. 719-730.

See also

- Cost of capital
- Modigliani-Miller theorem
- Discounted cash flow
- Net present value
- Internal rate of return
- Economic Value Added

External links

- Video about practical application of the WACC approach (<http://www.wacc.de/index.htm#Example>)
- Information Quality and Cost of Capital (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=846546)
- Ignacio Vélez-Pareja, Politécnico Grancolombiano - Department of Business Management and Joseph Tham, Duke University - Duke Center for International Development in the Sanford Institute of Public Policy; Duke University - Center for Health Policy, Law and Management A Note on the Weighted Average Cost of Capital WACC (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=254587) Solving the Circularity Problem
- calculate the WACC with your own values to understand the equation (<http://formularium.org/?go=96>)
- [R.D. Cohen - Spreadsheet to create *WACC curve* (<http://rdcohen.50megs.com/capstruct.htm>)]

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Operating Income, Residual Income And EVA[™]: Which Metric Is More Value Relevant? [1].(Brief Article)

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This study empirically examines the value-relevance of three profitability measures: Operating Income (OI), Residual Income (RI), and Economic Value Added (EVA[™]). [1] Motivation for the research emanates from the popular press's touting of EVA[™] as the hottest buzzword in Corporate America. As defined by Stern Stewart, EVA[™] is the difference between a company's net operating income after taxes and its cost of capital of both equity and debt (Stern Stewart, 1993). Three decades of research have found that accounting earnings have information content, but the superiority of EVA[™] over accounting earnings has only recently been empirically studied. Addressing this question is the main purpose of this study.

While the term EVA[™] appeared as early as 1989 (Finegan, 1989), it received little attention until a September, 1993 article in Fortune magazine (Tully, 1993). The Fortune article provided a detailed description of the EVA[™] concept, Stern Stewart practice, and successful EVA[™] adoptions by major corporations in the US. Following the article's kudos of EVA[™] as the most recent innovation in corporate performance measurement, a flurry of papers were published, primarily in the popular press and practitioner journals, to promote EVA[™] (e.g., Walbert, 1993; Birchard, 1994; Brossy and Balkcom, 1994; McConville, 1994; Bennett, 1995; Ochsner, 1995; Stewart, 1995; Birchard, 1996; Davies, 1996; Gapenski, 1996; Lehn and Makhija, 1996).

As the primary promoter of EVA[™], Stern Stewart & Company has been the consultant for over 200 companies applying the EVA[™] paradigm to financial management and incentive compensation (Stern Stewart & Co., 1997). The list of EVA[™] adopters includes companies such as: Allied Holdings, Briggs & Stratton, Coca Cola, CSX, Dun & Bradstreet, Eli Lilly, Federal-Mogul, Georgia-Pacific, Monsanto, Olin, R.R. Donnelley, Sprint, SPX, Toys R Us, and Whirlpool (Stern Stewart & Co., 1999 web site: <http://www.sternstewart.com>).

Although anecdotal stories may differ in detail among EVA[™] users, a common theme seems to be that EVA[™] adoption leads to a dramatic improvement in stock performance. For example, Coca Cola's stock returned about 200% from the inception of EVA[™] in 1987 to the middle of 1993; similarly, CSX's stock price soared from \$28 to \$75 between 1988 and 1993 (Tully, 1993). As John Blystone, CEO of SPX Corporation, stated in a Stern Stewart & Co. advertisement, "In the first half of 1996 . . . We have created \$135 million in market value for our shareholders, a 67% increase . . ." (Stern Stewart & Co., 1996). Eli Lilly also experienced similar performance; since adopting EVA[™], its stock price increased 105% in a year (Davies, 1996).

EVA[™]'s purported ability to deliver superior stock returns appears to be its main selling point as evidenced by the following Stern Stewart advertisement: "Forget EPS, ROE and ROI. EVA is what drives stock prices" (Stern Stewart & Co., 1995). Consequently, it is not surprising that the investment community has begun including EVA[™] in its analyses. As Alfred Jackson, director of global equity research of Credit Suisse First Boston, straightforwardly put it in a recent Stern Stewart & Company advertisement, "At CS First, we use EVA[™] as our primary equity valuation tool because it works" (Stern Stewart & Co., 1997). "Goldman Sachs is on board too" (Lowenstein, February 13, 1997: C1). It has even been predicted that EVA[™] will replace Earnings Per Share (EPS) in The Wall Street Journal's regular stock and earnings reports (Zarowin, 1995). Given this rhetoric, it is not surprising that companies are increasingly enticed to the EVA[™] bandwagon.

While successful EVA[™] stories are quite encouraging, the evidence supporting the

rhetoric has been primarily anecdotal. Insufficient empirical research exists to support the claim of EVA[TM]'s supremacy as a performance measure in terms of value-relevance. In contrast, limited empirical evidence has suggested otherwise. A sample of 566 U.S. firms was the basis for a study of ten-year average measures of EVA[TM] (as calculated by Stern Stewart in its database) versus traditional accounting measures (Dodd and Chen, 1996; Chen and Dodd, 1997). The work of Dodd and Chen (1996) and Chen and Dodd (1997) concludes that although improving EVA[TM] performance is associated with a higher stock return, the strength of association is far from what has been claimed by EVA[TM] proponents. They show that simple accounting earnings are of significant incremental information value in addition to EVA [TM] measures and that EVA[TM] is empirically comparable to residual income, a relatively old managerial accounting concept.

Using different testing procedures and a pooled cross-sectional sample of 6,513 firm-years, Biddle et al. (1997) provide evidence refuting the assertion that EVA[TM] is more highly associated with stock returns than accounting earnings and operating cash flows. In contrast, their results find that simple, unadjusted accounting earnings are more highly associated with stock returns than EVA[TM]. Similarly, Clinton and Chen (1998) conclude that companies using EVA[TM] should consider a relatively simple metric based on unadjusted accounting earnings, residual cash flow (RCF), rather than EVA[TM]. Both studies suggest the complexities involved in EVA[TM] calculations may not be cost justified. However, the advertised idea of investing only in those activities in which the profit exceeds the estimated cost of capital is an appealing concept, an analysis paradigm that may quickly draw companies to EVA [TM] before they fully analyze the older, simpler metrics (the ones not being advertised).

Proponents argue that EVA[TM] is a philosophical change in how companies run their businesses and that EVA[TM] is the only measure that they need (Stewart, 1995). In a mail survey of EVA[TM]-adopters and non-adopters, Dodd and Johns (1999) conclude that the subtle changes that Stewart suggests will occur after embracing EVA[TM] may not necessarily be desirable changes. They find that EVA[TM]-adopters tend to de-emphasize customer satisfaction measures more than those non-adopters. This may indicate longer-term problems for companies focusing on EVA[TM] to the exclusion of other non-financial measures.

The empirical work in this study is based on a valuation model used in prior studies (Dodd and Chen, 1997; Easton and Harris, 1991). Use of the theoretical model should add credibility to the empirical findings of this study. The valuation model is estimated cross-sectionally by year as well as using pooled cross-sectional and intertemporal data. This design facilitates the use of testing procedures that are common in the information content literature and, therefore, eases the comparison of this study with those in the literature.

Valuation Model and Hypothesis Development

Traditionally, financial reporting has emphasized accounting earnings, even though equity valuation theory maintains that future cash flows determine a company's stock price. As reflected in the FASB's Statement of Financial Accounting Concepts No. 1 (1978), a typical argument in favor of accounting earnings is that information about earnings is a better indicator of an enterprise's present and future ability to generate cash flows than information about cash receipts and payments per se. While the statement of cash flows has been required since 1987 (FASB Statements of Standards number 95, 1987), the investment community's reliance on earnings today is probably no less than before its requirement.

This focus on earnings is not a surprising phenomenon considering that most investors are concerned about a company's ability to produce long-term earnings and dividends. Many different valuation models developed by the investment community

include earnings as a primary input (Foster, 1986; Lev, 1989). For better or worse, the Price-Earnings (P/E) ratio is one of the more frequently cited financial indicators in the stock market. Therefore, it follows naturally that management, in response to the investment community's concern, relies on accounting earnings as a primary measure of corporate performance.

Due to the prominent role of accounting earnings in security analysis, assessing the usefulness of earnings to investors has become the most concerted research effort in accounting history. Pioneered by Ball and Brown (1968), accounting researchers have produced numerous studies investigating the empirical relation between security returns and accounting earnings (see Lev (1989) for a summary of the research). Lacking formal valuation models linking accounting earnings to security prices, most researchers follow Ball and Brown (1968) and concentrate on examining the relationship between abnormal returns and unexpected earnings. A considerable body of evidence shows the information content of earnings; however, the association of abnormal returns with unexpected earnings has persistently been weak as reflected in low R-squared statistics. To provide an alternative specification for the returns/earnings relation, Easton and Harris (1991) used a formal valuation model linking both earnings levels and earnings changes to raw stock returns as follows (see Easton and Harris (1991) for...


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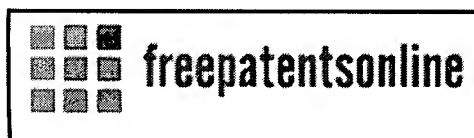
Word	Frequency
amount	4
annual	5
answers	10
apparatus	9
applying	1
asset	8
available	7
background	12
balance	4
based	6
business	4
but	4
calculating	2
cause	2
causes	2
choice	1
claims	1
client	4
common	17
company	8
comprise	14
comprising	17
computer	33
configured	7
contact	2
contacted	4
contract	10
control	4
corporate	4
costs	12
country	4
creditors	4
criteria	13

current	2
currently	4
customer	43
customers	5
cycle	4
data	16
database	12
debt	24
default	6
describing	2
description	1
determine	1
determining	2
display	2
displayed	4
displaying	7
displays	4
distribution	4
early	8
either	4
electricity	13
electronic	6
energy	4
enter	5
entered	3
entering	3
entry	1
equity	51
escalator	5
existing	5
facilitate	1
facilitating	2
facilities	4
facility	11
finance	7
financing	96
fuel	13
generate	2
generated	12
generation	10
heat	5
high	11
includes	2
including	6
increase	5
information	18
initiating	1
inquiry	2
interest	5
interested	12
interface	7
investor	4
ipo	4
junior	4
leasing	7
least	30

lenders	4
limited	7
listing	10
medium	3
method	21
more	4
non	4
number	5
off	4
one	34
operating	5
opportunities	2
optimizing	4
outstanding	5
paid	4
partnership	7
percentage	5
plant	9
plants	8
plurality	11
position	4
potential	4
power	12
pre	4
prices	19
principal	5
private	7
product	4
programmed	3
project	20
projected	16
projections	5
prompt	8
prompting	14
proper	3
property	3
pursue	2
questions	27
rate	15
readable	3
recommendation	2
recommended	1
record	3
recourse	4
regarding	7
related	7
relating	11
remaining	10
requested	2
requesting	2
required	8
requirement	14
requirements	1
residuals	4
results	1
revenues	5

rules	4
screen	16
select	2
selected	2
selecting	1
selection	3
selections	11
selling	4
senior	4
server	9
share	4
sheet	4
size	5
specific	12
stage	8
step	4
steps	4
structured	4
submitted	3
subordinate	4
subordinated	4
system	20
taxes	4
term	5
tool	1
trade	4
transaction	2
transactions	2
type	26
types	4
under	10
upon	7
upside	4
valuate	4
valuation	13
values	7
whereupon	1
whether	2
willing	12
wish	2
years	5
yield	11

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Abstract:

Methods and systems for operating a computer to facilitate financing inquiries about possible financing transactions are described. The method includes the steps of prompting a customer to select a financing type or prompting the customer to provide background information related to a financing requirement and providing the customer with a recommended financing product. The system is, in the exemplary embodiment, accessible to the customer via a network such as a wide area network, for example, an extranet accessible via the Internet, so that the customer can query the database and identify financing types that meet specific requirements.

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Claims:

1. A method for operating a computer to facilitate a choice of a financing product, said method comprising the steps of: prompting a customer to provide information related to a financing requirement; determining a proper financing product based upon provided information; and prompting the customer with a recommendation for a financing product.
2. A method according to claim 1 further comprising the step of displaying a computer generated screen listing a plurality of financing type selections.
3. A method according to claim 2 wherein said financing type selections comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.
4. A method according to claim 3 wherein for a project common equity financing type selection, prompting the customer to provide information comprises the step of displaying a computer generated screen prompting the customer to enter criteria to value the equity in their property.
5. A method according to claim 4 wherein the property is a power generation plant, the criteria requested being at least one of power plant information, current financing information, projected electricity prices and projected fuel costs.

6. A method according to Claim S wherein default values are available for at least one of projected electricity prices and projected fuel costs, when specific values are not provided.
7. A method according to claim 3 further comprising the step of displaying a computer generated screen describing a selected financing type.
8. A method according to claim 1, wherein prompting the customer to provide information comprises the steps of: displaying a computer generated screen listing a plurality of background questions relating to the financing requirement; and displaying a computer generated screen listing a plurality of financing specific questions.
9. A method according to claim 8, wherein the background questions relating to the financing requirement comprise at least one of the country where financing is required, which energy related business is the financing for, is the financing required for an operating asset, are U.S. taxes currently being paid by the customer, is the customer interested in either of off-balance sheet or non-recourse financing, and is the customer interested in structured debt such as high yield debt or subordinated debt.
10. A method according to claim 8, wherein the financing specific questions comprise at least one of amount of financing, selling or optimizing equity position, willing to share control, upside potential and residuals of the asset, willing to subordinate equity distribution to a preferred equity investor, willing to be contacted regarding the financing, early stage pre-IPO company or company in early stage of corporate cycle and interested in financing senior to common equity but junior to lenders and trade creditors.
11. A computer programmed to: prompt a customer to provide information related to a financing requirement; determine a proper financing product for the customer; and prompt the customer with an inquiry as to whether they wish to pursue financing opportunities.
12. A computer according to claim 11 further programmed to display a computer generated screen listing a plurality of financing type selections.
13. A computer according to claim 12 wherein said financing type selections comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.
14. A computer according to claim 13 wherein for a project common equity financing type selection, said computer displays; to the customer, a prompt to enter criteria to value the equity in

their property.

15. A computer according to claim 14 wherein the prompt is an interface to a valuation tool for power generation plants, the criteria requested being at least one of power plant information, current financing information, projected electricity prices and projected fuel costs.

16. A computer according to claim 15 wherein default values for at least one of projected electricity prices and projected fuel costs are available.

17. A computer according to claim 13, whereupon a selection of a financing type by the customer, said computer programmed to display, to the customer, a computer generated screen describing the selected financing type.

18. A computer according to claim 11, wherein to prompt the customer to provide information, said computer: displays a computer generated screen listing a plurality of background questions relating to the financing requirement; and displays a computer generated screen listing a plurality of financing specific questions upon entry of answers to background questions.

19. A computer according to claim 18, wherein the background questions relating to the financing requirement comprise at least one of the country where financing is required, which energy related business is the financing for, is the financing required for an operating asset, are U.S. taxes currently being paid by the customer, is the customer interested in either of off-balance sheet or non-recourse financing, and is the customer interested in structured debt such as high yield debt or subordinated debt.

20. A computer according to claim 18, wherein the financing specific questions comprise at least one of amount of financing, selling or optimizing equity position, willing to share control, upside potential and residuals of the asset, willing to subordinate equity distribution to a preferred equity investor, willing to be contacted regarding the financing, early stage pre-IPO company or company in early stage of corporate cycle and interested in financing senior to common equity but junior to lenders and trade creditors.

21. A database comprising: data corresponding to answers to questions relating to a customers financing requirement; and data corresponding to a recommended financing type for the customer.

22. A database according to claim 21 wherein data corresponding to answers further comprises data corresponding to answers to at least one of background questions and financing specific questions relating to the customers financing requirement.

23. A database according to claim 21 further comprising data corresponding to a valuation of one or more facilities.
24. A database according to claim 23 wherein the facilities are power generation plants.
25. A database according to claim 21 further comprising data corresponding to default values for electricity prices and fuel costs.
26. A database according to claim 21 further comprising data corresponding to a description of available financing types.
27. A system for facilitating financing transactions, said system comprising: a database comprising data corresponding to available financing type selections; and a server configured to prompt a customer to type and to prompt the customer provide answers to questions relating to a financing requirement.
28. A system according to claim 27 wherein said database further comprises data corresponding to answers to at least one of background questions and financing specific questions relating to the customers financing requirement.
29. A system according to claim 27 wherein said database further comprises data corresponding to a valuation of one or more facilities.
30. A system according to claim 29 wherein the facilities are power generation plants.
31. A system according to claim 27 wherein said server is configured to cause a screen listing a plurality of available financing type selections to be displayed at a client computer.
32. A system according to claim 31 wherein the financing type selections comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.
33. A system according to claim 32 wherein for a project common equity financing type, said server causes to be displayed at a client computer a screen prompting the customer to enter criteria to value the equity in their facility.
34. A system according to claim 33 wherein said server is configured to generate a valuation of equity in a facility based upon customer entered criteria.
35. A system according to claim 33 wherein the valuation criteria includes at least one of the plant size, a heat rate, a percentage of

revenues under contract, a number of years remaining under contract, a remaining term of the existing debt, an outstanding principal, interest rate, electricity prices and an annual rate of increase, and projections of prices and projected fuel costs including an escalator.

36. A system according to claim 35 wherein said database further comprises data corresponding to default values for electricity prices and projected fuel costs.

37. A system according to claim 36 wherein said server is configured to use default values for at least one of electricity prices and projected fuel costs based upon customer entered valuation criteria.

38. A method for initiating a financing transaction for a facility, said method comprising the steps of: selecting, from an electronic interface, a financing type; entering, into the electronic interface, contact information and information regarding the financing transaction; and requesting, from the electronic interface, a further contact regarding the financing.

39. A method according to claim 38 wherein the financing types comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.

40. A method according to claim 38 wherein for a project common equity financing type, said method further comprises the step of entering, into the electronic interface, criteria for valuation of the facility.

41. A method according to claim 40 wherein criteria for valuation of the facility comprises at least one of the plant size, a heat rate, a percentage of revenues under contract, a number of years remaining under contract, a remaining term of the existing debt, an outstanding principal, interest rate, electricity prices and an annual rate of increase, and projections of prices and projected fuel costs including an escalator.

42. A method for determining a proper financing type for a facility, said method comprising the steps of: entering, into an electronic interface, answers to background questions and answers to financing specific questions regarding the financing requirement; and requesting, from the electronic interface, a financing type recommendation.

43. A method according to claim 42 wherein the background questions comprises at least one of the country where financing is required, which energy related business is the financing for, is the financing required for an operating asset, are U.S. taxes currently

being paid by the customer, is the customer interested in either of off-balance sheet or non-recourse financing, and is the customer interested in structured debt such as high yield debt or subordinated debt.

44. A method according to claim 42 wherein the financing specific questions comprise at least one of amount of financing, selling or optimizing equity position, willing to share control, upside potential and residuals of the asset, willing to subordinate equity distribution to a preferred equity investor, willing to be contacted regarding the financing, early stage pre-IPO company or company in early stage of corporate cycle and interested in financing senior to common equity but junior to lenders and trade creditors.

45. Apparatus comprising: means for prompting a customer to select a financing type; means for prompting the customer to provide information related to a financing requirement; and means for prompting the customer with an inquiry as to whether they wish to pursue financing opportunities.

46. Apparatus according to claim 45 wherein said means for prompting a customer to select a financing type comprises means for displaying a computer generated screen listing a plurality of financing types.

47. Apparatus according to claim 46 wherein said financing types comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.

48. Apparatus according to claim 47 wherein for project common equity, said means for prompting the customer to provide information displays a computer generated screen prompting the customer to enter information for a valuation of a facility.

49. Apparatus according to claim 48 wherein information for valuation of a facility comprises at least one of the plant size, a heat rate, a percentage of revenues under contract, a number of years remaining under contract, a remaining term of the existing debt, an outstanding principal, interest rate, electricity prices and an annual rate of increase, and projections of prices and projected fuel costs including an escalator.

50. Apparatus according to claim 49 wherein information for valuation of a facility comprises default values for at least one of electricity prices and projected fuel prices.

51. Apparatus according to claim 45 wherein said means for prompting the customer to provide information comprises means for displaying a computer generated screen listing a plurality of questions, including at least one of background questions and

financing specific questions relating to the customers financing requirement.

52. Apparatus according to claim 51 wherein the background questions comprise at least one of the country where financing is required, which energy related business is the financing for, is the financing required for an operating asset, are U.S. taxes currently being paid by the customer, is the customer interested in either of off-balance sheet or non-recourse financing, and is the customer interested in structured debt such as high yield debt or subordinated debt.

53. Apparatus according to claim 51 wherein the financing specific questions comprise at least one of amount of financing, selling or optimizing equity position, willing to share control, upside potential and residuals of the asset, willing to subordinate equity distribution to a preferred equity investor, willing to be contacted regarding the financing, early stage pre-IPO company or company in early stage of corporate cycle and interested in financing senior to common equity but junior to lenders and trade creditors.

54. A system for facilitating financing transactions for one or more power generation plants, said system comprising: a database comprising data corresponding to available financing type selections for power generation plants; and a server configured to prompt a customer to provide answers to questions relating to power generation plant financing requirements.

55. A system according to claim 58 wherein said database further comprises data corresponding to answers to at least one of background questions and financing specific questions relating to the customers financing requirement.

56. A system according to claim 58 wherein said server is configured to cause a screen listing a plurality of available financing type selections to be displayed at a client computer.

57. A system according to claim 60 wherein the financing type selections comprise at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.

58. A system according to claim 61 wherein for a project common equity financing type, said server causes to be displayed at a client computer a screen prompting the customer to enter criteria to value the equity in their power generation plants.

59. A system according to claim 62 wherein said server is configured to generate a valuation of equity in one or more power generation plants based upon customer entered criteria.

60. A system according to claim 62 wherein the valuation criteria for the power generation plants includes at least one of the plant size, a heat rate, a percentage of revenues under contract, a number of years remaining under contract, a remaining term of the existing debt, an outstanding principal, interest rate, electricity prices and an annual rate of increase, and projections of prices and projected fuel costs including an escalator.

61. A computer-readable medium, comprising: a record of customer submitted facility data; a plurality of rules for calculating equity in a facility, based upon customer submitted data; and a record of results from applying said rules to the customer submitted data.

62. A computer-readable medium according to claim 65 wherein said rules for calculating equity comprise rules based upon at least one of plant size, a heat rate, a percentage of revenues under contract, a number of years remaining under contract, a remaining term of the existing debt, an outstanding principal, interest rate, electricity prices and an annual rate of increase, and projections of prices and projected fuel costs including an escalator.

63. A computer-readable medium according to claim 65 comprising a record of financing type selections comprising at least one of project finance, high yield debt, leasing, project common equity, limited partnership, private equity and preferred equity.

Description:

BACKGROUND OF INVENTION

[0001] This invention relates generally to methods and systems for facilitating financing transactions and more particularly to methods and systems for facilitating customer initiation and selection of a financing product.

[0002] Operators sometime determine that it is more economical to finance a facility using a different financing type than their existing financing . For example, operators of a power generation plant which is financed through a conventional mortgage type note sometimes determine that giving an equity stake to another entity is better.

[0003] For example, a purchaser of an equity stake, may be able to find purchasers of energy that current operators have been unable to locate, thereby operating the plant closer to maximum output, and theoretically, at maximum profit. However, finding potential purchasers of equity stakes, or providers of other types of financing is expensive and time consuming.